Assessment Districts
Balboa Island (#87) vs Little Balboa Island (#78)
Why are the costs per parcel so different?

The following discussion provides more detail regarding AD #87's proposed costs and how they compare to AD #78's actual costs. AD #78 (Little Island) was formed in 2000. Overall, the cost to do this work has risen – fairly significantly – in the nine years since 2000.

Additionally, the City has changed its policies – the change includes better post-job paving standards, improved customer service during design and construction and, in the current economy, an effort to recover the City's actual costs for assessment district work.

What's included in the Assessments? Costs related to the actual undergrounding work and the formation of the Assessment District are included in the assessments. These costs include:

- Design and construction of the underground system by SCE and AT&T;
- The complete restoration of streets and alleys after the construction;
- City project management including engineering, finance, administration, construction inspection, coordination with residents to minimize impacts to residents; and
- Financing costs including financial advisors, legal counsel, the cost to issue, sell bonds, fund a bond reserve, and pre-fund interest (if necessary).

The underground assessment district process is resident-driven by local proponents who wish to explore the possibly of undergrounding overhead utilities. It is a democratic process by which the majority of the property owners get to decide whether or not to proceed. The City only guides the process and, if necessary, secures bond financing for property owners that do not pre-pay their assessment in cash. As the undergrounding provides a special and direct benefit to property owners that reside within the district, it is appropriate that the improvements are funded by property owners within the district as opposed to funding the improvements from the general taxes of the City.

The only exceptions to the funding rules are:

1. If the City owns public property within the district, then public funds must be used to pay the City's assessments; and
2. If the City has previously scheduled improvement projects within the area, then that work could be combined with the district.

For example, when underground work occurs within the alleys, the assessment district must replace the alley paving as a part of the AD work. Ordinarily, the assessments would include the full cost of repaving the alleys. But if several waterlines within the alleys were planned for replacement, that waterline work can happen concurrent with the AD work. Doing so could result in the assessments being reduced because approximately 50% of the alley paving would be paid for using City water funds.

What do Utility Construction Costs Include? These costs include all costs incurred by AT&T and Southern California Edison (SCE) required to design and construct the underground system. They include:

- Design and engineering the AD;
- Labor costs;
- Materials costs like conduit, wiring, vaults, pullboxes, transformers, other electrical components;
- Logistical costs like traffic control, construction material storage, and the contractor's overhead; and
- The restoration of alleys, streets, and other public improvements to a condition consistent with the pre-construction condition.

Connection costs to convert overhead utilities to underground utilities on private property ("private hookups") are not included in the district.

The City fronts the assessment district's design costs. If the formation of the assessment district is successful, then the City is reimbursed for these costs. If not, then the City's taxpayers are out the design costs.

Both SCE and AT&T are responsible for pricing and/or obtaining construction bids for their undergrounding work. These are private utilities governed by the California Public Utilities Commission (CPUC), but they are not required to disclose their itemized costs for the work.

Construction prices have risen significantly over the last 10 years. For example, Balboa Island AD #87 had 38% higher SCE costs and 16% higher AT&T costs than Little Island AD #78. This increase is consistent with 9 years of rising labor and material costs per the *Engineering News Record*'s (ENR) construction index which rose 34% from 2000 to 2009.

About the "Equivalent Overhead Contribution". When overhead utilities are put underground, the utility companies end up with a new system including new conduit, wiring, vaults, transformers, and other new equipment. These new systems often replace aging overhead systems. Because it is not the responsibility of homeowners to upgrade aging systems, the CPUC says that utility companies must credit the value of the installation of new overhead facilities replacing the existing overhead system. In the past, the equivalent overhead contribution has been deducted from the utility construction cost line item. In recent districts, we have included this credit as a separate line item to show the amount of the credit. These contributions are calculated by the utility companies per the rules and guidelines established by the CPUC.

The existing overhead system in AD #87 is a 4 kilovolt (kV) system. Therefore, the utility company is required to credit the replacement of the 4kV system. However, SCE's current voltage standard has been changed to 12kV, which one might argue that they should credit the value of a 12kV system. While the credit was based on a 4kV system, SCE reports that any cost differential between a 4kV and 12kV overhead system is negligible, as a significant portion of the cost to construct an overhead system is unaffected by voltage level. For example, SCE states that the cost of labor and materials to install wood poles, cross arms, bracing, guy poles and service wire is the same for both voltage levels. Also, they state that the labor to install conductor and electrical equipment such as transformers and switches is also the same for both voltage levels. They maintain that the only potential area of cost differential would be in the pricing of conductor and electrical equipment and these differences would be negligible, if they exist at all.

Other Construction Costs. Other construction costs for a typical Assessment District include:

1 – Street and Alley Rehabilitation – When you underground utilities, an extensive amount of street and alley rehab may need to be done. The amount of street and alley rehabilitation work has varied depending on the particular district and the condition of the existing improvements. The Street/Alley Rehabilitation line item for various districts represents street and alley work that was subtracted from the SCE and AT&T work – this was done so that the City could administer the work separately.

The City typically does this when there is a substantial amount of City-funded work (paid with revenue sources other than assessments) that would be done in conjunction with the assessment district. But the cost listed in the *Street/Alley Rehabilitation* line item is the district's contribution to the City project.

a) **When the Current Streets are in Good Condition.** The Balboa Island AD envisioned a larger street and alley rehabilitation program than many other districts – in part because of the good condition of the existing alleys. The City's current street and alley rehabilitation approach requires that assessment districts which occur in areas with good or excellent streets and alleys include all costs to replace full concrete panels in alleys and full lane widths in streets.

   This "full panel replacement" policy resulted from City's experience with AD #78 on Little Island. When formed in 2000, AD #78 did not include any rehabilitation of the streets and alleys. It only included resurfacing the trenches. After AD #78 completion, many residents were upset over the poor appearance of the streets and alleys because of the trench cuts. In the 2001/02 budget, the City Council approved a $400,000 pavement replacement project to redo the streets and alleys within the district. This work, if it was charged to the AD, would have resulted in an additional $1,750 per parcel charge. Since then, the City has included full panel replacements on all of its AD work as well as all trenching on City and utility projects to eliminate unsightly trench cuts.

b) **When the Current Streets are in Fair to Poor Condition.** If the streets and alleys within a district are in a fair to poor condition and are scheduled for major rehabilitation or replacement within the current or an upcoming City Budget, that paving work is deducted from the utility construction cost of the assessment district.[1] Additionally, the City reviews the condition of its water and sewer lines within the assessment district. If we find that they are due for replacement[2], the water and sewer line trench paving work is also deducted from the utility construction cost. The separate City project combines the districts share of the paving with the City maintenance projects resulting in an overall savings to the assessment district. The following is a brief summary of rehabilitation work done in conjunction with the Balboa Island and Little Island assessment districts:

   i. Balboa Island. A separate phased paving project was to be managed by City. The AD would have contributed $3,436,000 to the paving, water line and sewer line replacement project ($3,850,000). The City paving project would have received water and sewer enterprise fund contributions for some water line and sewer line replacements within the alleys including Park and Balboa Avenues. Also, the project envisioned a City gas tax contribution for paving rehabilitation on Balboa Avenue due to its poor pavement condition.

[1] The City maintains a street and alley pavement replacement program. Street paving is replaced in kind depending on whether the street is asphalt or concrete. Asphalt alleys are replaced with concrete due to favorable cost benefit calculations including longer design life and maintenance savings.

[2] The City maintains a water and sewer master plan with replacement schedules and guidelines.

ii. Little Island. There was no rehabilitation work included which led to the problems mentioned previously and the Council policy change regarding paving requirements in ADs. In a subsequent budget, the City appropriated $400,000 of General Fund dollars to replace alleys and certain streets on Little Island. The Council changed the policy because they did not want the rest of the City's taxpayers to subsidize assessment district projects.

2 – Construction contingency - The construction contingency is required by the City to allow for unforeseen conditions. Typical City construction projects usually have a 10% contingency. AD #87's contingency was set at 8% and AD #78's contingency was set at 9%. Contingencies are especially important in assessment districts since the utilities and the City cannot obtain additional funding from the property owners after formation of the district. Unforeseen conditions can include:

- Conflicting existing utilities;
- Poor soil conditions; or
- The need for additional paving replacements that were not anticipated.

Any unused contingency at the end of the work gets returned to the property owners or is credited to the outstanding bond (resulting in a benefit to the parcel owners).

Incidental Expenses. Incidental expenses are the costs associated with the formation of the assessment district. In general, these include assessment engineering, legal counsel, financial advisors, City administration, and miscellaneous processing costs and contingencies.

Two key "incidentals" differed between 2000 and 2009 – these are the Construction Inspection and City Administration costs:

- Private Sector Construction Inspection – Typically, SCE hires and manages the contractors who install the underground construction. The City issues an encroachment permit to SCE and oversees SCE's work in the public right of way to ensure safety, public access, preservation of public and private property, and the quality of replacement public infrastructure such as street paving, alleys, and sidewalks.

  That was OK for the much smaller (229 parcel) AD #78. But the size, complexity, and the timing of AD #87 required the City to take a more prominent role to supervise, coordinate, and communicate with residents and businesses. Early discussions with the proponents recognized this unique situation and confirmed the desire for an additional level of coordination and management. With dedicated contract (private sector) staff, the City would be able to provide immediate response and special attention to residential issues such as blocked access, contractor damage, noise, and parking problems. The contract inspector would also coordinate with Island residents that have homes under construction, deliveries, and special events. The potential construction schedule for AD #87 envisioned a three-year time frame for the utility company underground work and a two-year time frame to complete conversions along with water, sewer, alley and street reconstruction.

  The projected cost for this project manager, including overhead, was conservatively estimated at up to $200,000/year at current market rates (approx. $100/hr including overhead costs). With 50% of the costs to be shared with the City, the projected cost to AD #87 was $500,000 (roughly $423/parcel). As with the construction contingency, if the AD project took less time, then the inspection funding would be refunded to the property owners or used to pay down the bonds (also resulting in savings to the assessment payers).

At Little Island, the City relied upon the utility companies to manage the work – and we had less than perfect results. The City ultimately provided additional coordination to remedy the problematic situations that occurred in this district. Because the cost to provide inspection services and direct project management could not be added to the assessments, the City again (like the pavement) effectively subsidized the Little Island district. Recognizing this problem, City staff better delineated its costs to develop full cost recovery strategies for future districts.

- City Administration - This line item in the assessment district costs includes actual City costs for engineering, finance, and miscellaneous staff for the management, processing and formation of the assessment district. Costs here include:

  - The selection and management of outside assessment district engineers, legal counsel and financial consultants;
  - Coordination with SCE and AT&T during the underground design and construction; and
  - Conducting informational community meetings, individual meetings, public hearings and workshops.

  As stated above, the need for more coordination and communications has driven the need for more participation by City staff to ensure a construction process that minimally disrupts residents and businesses for AD #87. City staff serves as an advocate for the public and their needs during the assessment district process from design through construction. Our City engineering staff works closely with SCE, AT&T, and their contractors to prevent and resolve problems that occur during design and construction.

  Similar to the construction inspection costs, the size, complexity and timing of AD #87 required more City staff time to manage and process the formation of the district. We estimated $400,000 over the five-year period for City administration of AD #87. AD #78 was relatively small in comparison and required less management and staff time. As with the construction inspection for AD #78, the City relied upon the utility companies to manage and coordinate the work with the community with inadequate results. The City ultimately provided additional coordination to remedy the problematic situations that occurred in this district. Because the cost to provide City staff to coordinate construction could not be added to the assessments, the City again (like the pavement and construction inspection) effectively subsidized the Little Island district.

Financing costs. An AD's financing costs include all the variable costs associated with financing the unpaid assessments after property owners have been provided the opportunity pay their assessment in cash. Those property owners that do not pre-pay their assessment in cash are subject to these costs. The three components of the financing costs are the underwriters' discount or bond discount, bond reserve, and pre-funded or capitalized interest. A typical Assessment District financing has a term of 15 years with payments made bi-annually along with property taxes on the Orange County Treasurer-Tax Collector's bill. The costs are as follows:

- Underwriter's/Bond discount. This financial cost typically is less than 1.5% of the amount to be financed. This cost is a service fee. These fees represent the underwriters' commission for purchasing, marketing and selling the bonds.

- Bond Reserve. The bond reserve fund (5-7% of the bond issuance amount) constitutes a form of security deposit for the bond holders. This reserve is held in place until the the assessment is paid off at which time it is returned to the owner of the assessed property.

- Pre-funded Interest (capitalized interest). The amount of pre-funded interest depends on the timing of the bond sale. In order for the County Tax Collector to mail tax bills in the Fall, the County imposes a tax levy deadline in mid August. To coincide with the property tax collection calendar, assessment district bonds are always dated September 1. Pre-funded interest represents the assumed interest rate times the amount of bonds issued times the number of months between the assumed bond sale date and the maturity date of the bonds (September 1). If bonds are sold after the deadline to place the assessments on the tax bill (August 14), then the first interest payment by the property owner will be one year in arrears. The term of the bonds is usually 15 years. In this situation, prefunded interest must be collected so that payments can begin immediately after the sale of bonds. While this amount may appear to add to the assessment, the reality is that the property owner is actually pre-paying the first payment of a 15-year term, so there will only be 14 payments to pay off the bonds. If the bonds are sold and it is possible to meet the County's deadline of August 14, then the pre-funded interest would be reduced to zero, but still, a full 15 years of payments would be made to pay off the bond. The net effect is that by the end of the bond repayment an assessment district with or without prefunded interest pays the same amount.

  The formation of AD #78 (Little Island) was completed shortly before the County's deadline and was not required to add pre-funded interest to their financial costs. Those property owners started making payments on their assessment immediately and will make 15 payments, less the bond reserve credit applied against the final installment. AD #87 was so large the financing team felt that the assessment may not be recorded with the County in advance of the August 14 deadline. Therefore, 12 months of pre-funded interest was added to the financial cost as insurance against the potential for a missed deadline[3]. If the district had been formed without protests in advance of the deadline, the City would have deducted the pre-funded interest from the financial costs and reduced the assessments accordingly.

The total cost of these three financing components ranges from 7 to 15%. AD #87's financing cost totaled 13.25% of the total assessment as follows:

Underwriter's Discount	1.50%
Bond Reserve	6.00%
Pre-funded Interest	5.75% (for 12 Months)
Total	13.25%

Those property owners that would have pre-paid their assessment in full would have received a discount of 13.25%. This equates to about a $2,300 savings on the average assessment of $17,287. Property owners that did not pay in full would have their assessment balance placed on the tax rolls. They would then make biannual payments to the Tax Assessor until the bonds are repaid.

The attached spreadsheet shows how the elements described above make the comparison between the Little Island AD #78 so different from the Balboa Island AD #87. For questions about this analysis, please contact the City at sbadum@newportbeachca.gov or (949) 644-3311.

[3] Once an assessment district is formed, the City cannot increase an assessment. However, the City can subsequently reduce assessments as necessary.